TAX & EXCHANGE CONTROL
ALERT

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INCORPORATING
KIETI LAW LLP, KENYA

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South Africa, with its sophisticated financial system has an extensive legal framework that regulates this system and its proper functioning. One of the components of this regulatory framework is South Africa's exchange control (Excon) regime, captured mainly in the Currency and Exchanges Act 9 of 1933, Exchange Control Regulations, 1961 (Regulations) and the Currency and Exchanges Manual for Authorised Dealers (AD Manual).

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The AD Manual, as discussed in previous Tax and Exchange Control Alerts, contains the permissions and exceptions contemplated in the Regulations. In *South African Reserve Bank and Another v Shuttleworth and Another* 2015 (8) BCLR 959 (CC), it was held, amongst other things, that the Excon regime (referring mainly to the Regulations in that case) was "*...introduced and kept to shore up the country's balance of payments position...to regulate and discourage the export of capital and to protect the domestic economy... The fickle nature of the international financial environment required the exchange control system to allow for swift responses to economic changes. Exchange control provided a framework for the repatriation of foreign currency acquired by South African residents into the South African banking system. The controls protected the South African economy against the ebb and flow of capital.*"

Transactions between South African and non-South African parties, in particular involving the cross-border transfer of funds, rights or interests between such parties, must comply with South Africa's Excon rules. In practice, this often means that Excon approval for a particular transaction will be included in the contract as a suspensive condition that has to be met and without which the agreement cannot become unconditional. Alternatively, even if not dealt with as a suspensive condition, may effect enforceability or a party's ability to perform, as the absence of exchange control approval will mean that the funds payable or the rights that need to be transferred abroad under the agreement, cannot be paid, or transferred abroad as such. Depending on the nature of the transaction and the permissions and exceptions provided for in the AD Manual read with the Regulations,

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a transaction will generally require either the approval of an authorised dealer (most South African banks) or the Financial Surveillance Department of the South African Reserve Bank (FinSurv).

The Dolberg case

The importance of obtaining the necessary Excon approval and its potential impact on a particular transaction, is illustrated by the judgment in *Dolberg Asset Finance Ltd v Dolberg South Africa (Pty) Ltd* (2020/25831) [2021] ZAGPPHC (20 September 2021) (Dolberg case).

In this case the applicant, a company registered in Mauritius (Mauritius Co) approached the court to enforce an intercompany guarantee that was granted by the respondent, registered in South Africa (SA Co), to Mauritius Co, in terms of a written finance agreement.

It was common cause between the parties that payment of the guarantee in question was dependent upon the fulfilment of a suspensive condition in the finance agreement, namely that payment under the guarantee is conditional upon the approval of an authorised dealer and/or the South African Reserve Bank (SARB), under which FinSurv falls, which approval the guarantor (SA Co) shall do everything in its power to obtain, when required. Mauritius Co argued, amongst other things, that SA Co had failed in its obligation to obtain the SARB approval and that it had consequently dismally failed in its obligation to do everything in its power to obtain the approval. Essentially, Mauritius Co's argument went even further as it contended that SA Co had to obtain SARB approval, as anything less would result in it not doing everything in its power to obtain approval.

In the current instance, the parties agreed that the flow or export of monies across the borders of any country to another country requires the necessary approval of the country's appropriate authority, which in the current case was the SARB. SA Co had instructed an authorised dealer (AD) to apply to the SARB for approval to make payment in terms of the guarantee to Mauritius Co. The judgment notes the most important information included in the AD's application, but for purposes of this article it is only relevant to note that the application (SARB application) indicated the amount to be transferred abroad as MUR54,311,776 and that the guarantee would yield an indirect benefit to South Africa, being the success of the Dolberg Group of companies, which could also benefit SA Co. The SARB (FinSurv) responded to the application as follows:

> *"I thank you for the information furnished and advise that, since there may not be direct financial or monetary benefit to South Africa and that there is no direct interest of shareholding between the parties concerned, we are unable to favourably consider the applicant's request. "*

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Mauritius Co alleged that the following conduct of SA Co, justified an inference that SA Co *"shrugged off its duty"* to do everything in its power to obtain approval:

- SA Co's alleged tardiness in providing Mauritius Co timeously with a copy of the SARB application.
- The belated advising of the denial of approval of the application.
- The half-hearted and unpersuasive content of the SARB application for approval of cross-border transfer of monies.
- Alleged material deficiencies in the SARB application, such as approbation and reprobation in describing the relationship between the two companies (unrelated foreign company and sister company), the absence of details of SA Co's position as guarantor in the group structure and the benefit of the finance agreement to the Dolberg Group.

SA Co disputed these submissions and the court held that where the SARB has a discretion whether or not to grant approval for the cross-border flow of monies, Mauritius Co's contention that SA Co was obliged to in fact obtain approval, at all costs, had no merit. As there was a value judgment to be made in respect of the value of the monies to be transferred and the reciprocal return value to be received within South Africa, there was no obligation on SA Co to in fact obtain approval.

The court re-iterated that the parties were aware that the grant of the approval was wholly within the SARB's discretion and its policies. The court noted that the facts on which Mauritius Co's above arguments were based were true. For example, Mauritius Co did not deny that it and SA Co were separate companies independent of each other and that there was no direct shareholding between them. Furthermore, the court decided that it was not of concern whether a "*further*" or "*better*" explanation of the benefit to the Dolberg Group in terms of the agreement should have been provided in the SARB application, as such explanation would only highlight the fact that South Africa would receive no reciprocal value through the cross-border flow of funds. As such, the court concluded that no negative inference could be drawn against SA Co. The court remarked that the SARB's discretion to grant approval is fettered and dependent on policy considerations which when considered in light of the common cause facts, resulted in the SARB application being refused.

The court also declined to grant the alternative relief sought by Mauritius Co, namely that SA Co be ordered to pay the guarantee amount into Mauritius Co's attorneys trust account for the benefit of South Africa, as this was "*bad in law*". This was because, amongst other things, the parties were aware that the agreement,

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that is, the guarantee, would be unenforceable if Excon approval was not obtained and as SA Co would commit an offence if it paid the guarantee amount into the trust account in this manner, as it would contravene Regulation 22 of the Regulations. It would circumvent the purpose of the suspensive condition of the guarantee to obtain SARB approval.

Observation

It is the view of many that the problems faced by the South African economy, some of which are seen as structural, have adversely affected foreign direct investment into South Africa. While it is hoped that this situation will improve, South African companies who are party to such cross-border transactions, would be well advised to consider the need for the contracting parties to comply with South Africa's exchange control rules that apply to the transaction at hand. An issue such as the one that arose in the *Dolberg* case, can easily be avoided if the parties receive the proper advice at an early stage, from advisors experienced in exchange control matters.

In addition, one should also note that South Africa's exchange control rules are often relaxed or amended, which could impact a particular transaction. By way of example, the AD Manual was amended earlier this year in Exchange Control Circular 4/2023 (see our Tax and Exchange Control Alert of 26 May 2023) to amend the rules for the issue of guarantees. Specifically, the amendment states that in the context of the outward investment regime for South African companies, dealt with in section B.2(C) of the AD Manual, a South African company can directly issue a foreign denominated guarantee to cover borrowing facilities of its authorised foreign subsidiary abroad, if it obtains prior FinSurv (SARB) approval.

Louis Botha

2023 RESULTS

Chambers Global 2018 - 2023 ranked our Tax & Exchange Control practice in **Band 1**: Tax.

Emil Brincker ranked by **Chambers Global 2003 - 2023** in **Band 1**: Tax.

Gerhard Badenhorst was awarded an individual spotlight table ranking in **Chambers Global 2022 - 2023** for Tax: Indirect Tax.

Stephan Spamer ranked by **Chambers Global 2019-2023** in **Band 3**: Tax.

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BBBEE STATUS: LEVEL ONE CONTRIBUTOR

Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

PLEASE NOTE

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